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C O N F I D E N T I A L SECTION 01 OF 04 BUENOS AIRES 001303

SIPDIS

E.O. 12958: DECL: 09/16/2028

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SUBJECT: EVERYTHING YOU EVER WANTED TO KNOW ABOUT USING
ARGENTINE CENTRAL BANK RESERVES TO PAY THE PARIS CLUB

REF: A. BUENOS AIRES 1286

[1](#)B. BUENOS AIRES 1270

[1](#)C. BUENOS AIRES 1263

[1](#)D. BUENOS AIRES 1236

[1](#)E. BUENOS AIRES 1224

Classified By: Ambassador E.A. Wayne for Reasons 1.4 (b,d)

Summary

[1](#)1. (C) Argentine President Cristina Fernandez de Kirchner's September 2 announcement that the GoA intends to use Central Bank reserves to pay Paris Club debt has spawned a local debate over the various legal and financial ramifications of using reserves for this purpose. The main issues relate to the legality of using Central Bank (BCRA) reserves, the availability of sufficient reserves, and the impact on the BCRA's balance sheet, the payment mechanism between the GoA and BCRA, and the possible repercussions on the BCRA's ongoing legal battle with "Holdout Bondholders" over \$105 million in frozen BCRA assets. GoA and BCRA officials tell Post that the GoA will need to issue a new decree amending the 1991 Convertibility Law to allow use of reserves to pay bilateral debt. There is disagreement over whether Congress should ratify this new decree. The BCRA has sufficient reserves to pay the Paris Club, but it could weaken the quality of its balance sheet during a time of increasing global financial uncertainty. BCRA officials believe the President's announcement will jeopardize the BCRA's case against holdouts, but believe Congressional approval of the new decree would strengthen their legal position before New York courts. End Summary.

Legal Issues Related to Using BCRA Reserves

[1](#)2. (SBU) In her September 2 announcement, and also in the accompanying presidential Decree 1394 (published September 3 in the Official Gazette), President Cristina Fernandez de Kirchner (CFK) announced the use of "freely available" reserves to pay Paris Club (PC) creditors. The GoA defined these "freely available" reserves in Decree 1599, issued December 15, 2005. Decree 1599 modifies Argentina's Convertibility Law (N23.928) to allow the use of "excess" reserves -- after backing 100% of the monetary base -- to pay debt to international financial institutions (IFIs), as long as this payment has no monetary effect (e.g., does not expand or contract the monetary base). This legal modification allowed the GoA and BCRA to use reserves to pre-pay

Argentina's entire \$9.53 billion debt to the IMF on January 3, 2006 (implemented via Presidential Decree #1601, also signed December 15, 2005). (Congress ratified Decree 1599 on December 21, 2005, as Law N26.076, which entered into effect January 9, 2006. Congress did not ratify Decree 1601.)

13. (C) The problem currently facing the GoA is that the Paris Club is comprised of bilateral creditors, and does not qualify as an IFI. Some private analysts -- including at JPMorgan and Credit Suisse -- speculate that the GoA could broadly interpret the Convertibility Law, as amended, to include the Paris Club. However, this is an ongoing debate within the GoA, with some parties arguing that all that is necessary is for the President to sign a new decree (a special "Necessity and Urgency Decree") that defines "IFI" as including the Paris Club, but many others claim that Congressional approval is required.

14. (C) The Economy Ministry's Finance Secretary, Hernan Lorenzino, who has the lead on Paris Club issues for the GoA, acknowledged officially to EconOff September 15 that the GoA and BCRA are analyzing whether it is enough just to amend the December 2005 Decree (#1599) -- thus modifying the Convertibility Law to allow payment of bilateral debt with reserves -- or whether Congressional approval is required. Post has heard through reliable third parties that both BCRA President Martin Redrado and Lorenzino personally believe a new decree is necessary. Redrado has apparently indicated his belief that Congress must ratify such a decree, but Lorenzino commented earlier this week to Japan's Ambassador in Buenos Aires that no such ratification is needed. Local press speculates that Redrado would open himself and the BCRA

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to lawsuits if he were to authorize the release of reserves without Congressional authorization (especially given the precedent of having Congress ratify the 2006 IMF payment).

15. (C) Post has consulted directly on this issue with Argentina's two main public sector experts on debt issues: Economic Ministry Debt Office Director Norberto Lopez Isnardi and BCRA Senior Manager of Foreign Exchange Reserves Juan Carlos Barboza, who until recently was the Economy Ministry's Deputy Finance Secretary. Lopez and Barboza (STRICTLY PROTECT BOTH) have privately informed EconOffs that in their opinion the Paris Club clearly does not fall under the definition of an "IFI." They say that the only way the GoA may proceed with the President's initiative in full adherence to Argentine law is to alter original Decree 1394 (or issue a new decree), amending the Convertibility Law again to allow use BCRA reserves to pay bilateral creditors, and/or get Congress to ratify it.

Availability of Reserves

16. (SBU) The BCRA easily has sufficient "freely available" reserves to pay the full debt owed to PC member countries. As of end-August, the monetary base stands at 99 billion pesos (roughly \$32.5bn) and total reserves are at 142.6 billion pesos (approximately \$47bn), which leaves freely disposable reserves at about 44 billion pesos, or \$14 billion. This is more than enough to pay the roughly \$6.7 billion in arrears to the PC, or even the entire \$7.9 billion, which includes principal outstanding. (In her September 2 announcement, CFK stated that the GoA would pay the PC in full, in a lump sum, and also stated incorrectly that the total amount due, including principal outstanding, was \$6.7 billion. Economy Ministry and BCRA contacts point out, to their relief, that the original decree (#1394) does not cite a fixed amount and does not state that the GoA will pay in a lump sum. However, it does say that the GoA will pay the entire PC debt, including principal outstanding.)

BCRA Limits on Lending to GoA

¶7. (SBU) If the GoA succeeds in changing the original decree to allow PC payment using "freely available" reserves, then this will not count against the BCRA's normal lending restrictions to the GoA, as established in the BCRA's Charter. The Charter currently limits short-term BCRA lending to the GoA at up to 12% of the monetary base. Additionally, the BCRA can grant short-term lending to the GoA of up to 10% of the last 12 months' tax collection, as long as it is used to pay IFIs.) However, in the unlikely case that the GoA is unable to issue a special decree or get Congress to amend the Convertibility Law, the only other option would be to amend the BCRA's Charter to expand these limits. Doing so would require Congressional action. As of the end of August, the GoA has maxed out the BCRA's short-term lending limits. (GoA short-term debt to the GoA is currently 21.3 billion pesos, or roughly 21% of the monetary base.)

Method of Payment

¶8. (SBU) According to media reports, BCRA and Economy Ministry officials are discussing the financial conditions of the bond that the GoA will issue to the BCRA in exchange for reserves. Reportedly, the Economy Ministry originally envisioned issuing a 10-year, non-tradable instrument similar to the one issued in December 2005 when the GoA prepaid its debt owed to the IMF. However, the BCRA prefers a shorter-term, tradable bond, and the most recent press reports indicate the two sides are close to compromising with a longer-term but tradable instrument.

Implications for BCRA Balance Sheet

¶9. (SBU) Although the BCRA can easily pay PC debt using "freely available" reserves, paying current arrears of \$6.7

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billion could have a negative impact on its overall balance sheet. (Note: Almost the entire debt of \$7.9 billion will be in arrears after November 2008, so it makes more sense to calculate the impact of the total due, rather than just arrears.) As of August 31, 2008, the BCRA states total assets of 246.28 billion pesos (roughly \$81 billion), including reserves, its holdings of GoA bonds, its short-term loans to the GoA (mentioned in the preceding paragraph), and other credits. The BCRA lists liabilities of 226.17 billion pesos (approximately \$74 billion), including monetary base, debts owed to IFIs, GoA deposits with the Central Bank, and over \$20 billion in BCRA short-term debt instruments. The BCRA's net wealth is roughly 20 billion pesos.

¶10. (SBU) The payment in full of Paris Club debt via reserves would simply involve changes in two BCRA balance sheet asset categories: a debit of cash or cash-like liquid assets, and an equivalent credit of additional GoA bond holdings or other GoA debt obligations to the BCRA. However, market participants tell us that such a shift will, from their perspective, notably deteriorate the quality of the BCRA's balance sheet, and this could raise private sector worries about the BCRA's ability to respond adequately to potential domestic liquidity and solvency crises in its role as lender of last resort. (Comment: This seems to us to be a legitimate concern, given global financial difficulties and also that Argentina's country risk spreads are at their highest point since the 2005 debt restructuring. End Comment.)

Implications for Holdout Lawsuits

¶11. (C) Many BCRA officials, including reserves manager Juan Carlos Barboza (PROTECT), are deeply concerned that the manner in which the GoA has declared it will use official reserves will undermine the BCRA in its legal battle with "holdout" bondholders (private bondholders who refused to accept Argentina's 2005 debt exchange). At this time, \$105 billion of BCRA reserves held at the Federal Reserve Bank of New York (FRBNY) are frozen on account of lawsuits submitted by EM Ltd (controlled by Kenneth Dart) and NML Capital Ltd (controlled by Elliott Associates) against the GoA (with the BCRA as an interested party).

¶12. (SBU) Plaintiffs EM and NML together hold defaulted bonds with a combined face value of approximately \$737 million. (The total face value of untendered GoA debt is approximately \$20 billion, or close to \$30 billion when including past-due interest. U.S. bondholders hold approximately \$3-4 billion of the total.) EM already holds and NML seeks a judgment against the GoA arising out of the December 2001 default. They sought to attach the BCRA funds held at the FRBNY under the argument that they were rendered attachable under the Foreign Sovereign Immunities Act of 1976 (FSIA) following President Nestor Kirchner's two decrees in December 2005 that gave the GoA the authority to use BCRA BCRA reserves to pay Argentina's debts to the IMF.

¶13. (SBU) The U.S. Court of Appeals for the Second Circuit ruled January 5, 2007, in support of an earlier ruling by the U.S. District Court for the Southern District of New York (Judge Thomas P. Griesa) against the Plaintiffs. The Appeals Court ruled that "the FRBNY Funds are immune from attachment under the FSIA because, notwithstanding the issuance of the decrees, the FRBNY Funds continue to be owned by the BCRA, a separate juridical entity from the Republic." The Court also commented that the FSIA only allowed attachment of a foreign state's property used for commercial purposes in the U.S., and "a government's repayment of its debt to the IMF is not a 'commercial activity.'" EM and NML have appealed the case to the U.S. Supreme Court. (The USG submitted an Amicus Curiae brief to the Appeals Court in support of this interpretation of the FSIA.)

¶14. (C) In part, Barboza believes the PC announcement has weakened the BCRA's case because of the clear difference between the IMF payment and the proposed Paris Club payment. Technically, according to BCRA officials, the BCRA owed the debt to the IMF, since it passed through the BCRA and then to the GoA. However, the Paris Club debt is clearly bilateral, so the GoA decision gives the appearance that the Argentine State can grab reserves at will, regardless of the legal

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separation between the two entities. For this reason, Barboza and other Post contacts say this makes it all the more important to get Congressional authorization of a new or amended decree, thus re-strengthening the legal delineation between the GoA and BCRA. Private sector analysts agree, and argue for clarifying that the GoA will "purchase" the BCRA reserves.

WAYNE